

LHC Group, Inc
Form 10-Q
November 05, 2009
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

☐ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2009

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to

Commission file number: 0-8082

LHC GROUP, INC.

(Exact Name of Registrant as Specified in Its Charter)

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Delaware
(State or Other Jurisdiction of
Incorporation or Organization)

71-0918189
(I.R.S. Employer
Identification No.)

420 West Pinhook Rd, Suite A

Lafayette, LA 70503

(Address of Principal Executive Offices Including Zip Code)

(337) 233-1307

(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter periods that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

Number of shares of common stock, par value \$0.01, outstanding as of November 3, 2009: 18,446,994 shares.

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LHC GROUP, INC.

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Table of Contents**PART I FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS.****LHC GROUP, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS***(Dollars in thousands, except share data)*

(Unaudited)

| | September 30, 2009 | December 31, 2008 |
|---|-----------------------|----------------------|
| ASSETS | | |
| Current assets: | | |
| Cash | \$ 2,508 | \$ 3,511 |
| Receivables: | | |
| Patient accounts receivable, less allowance for uncollectible accounts of \$9,989 and \$9,976, respectively | 68,753 | 61,524 |
| Other receivables | 3,154 | 2,317 |
| Amounts due from governmental entities | 1,431 | 2,434 |
| Total receivables, net | 73,338 | 66,275 |
| Deferred income taxes | 5,413 | 4,959 |
| Assets held for sale | 450 | |
| Prepaid income taxes | 4,147 | |
| Prepaid expenses and other current assets | 6,404 | 6,464 |
| Total current assets | 92,260 | 81,209 |
| Property, building and equipment, net | 20,058 | 16,348 |
| Goodwill | 130,285 | 112,572 |
| Intangible assets, net | 38,125 | 29,975 |
| Other assets | 2,620 | 3,296 |
| Total assets | \$ 283,348 | \$ 243,400 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Current liabilities: | | |
| Accounts payable and other accrued liabilities | 17,365 | 15,422 |
| Salaries, wages, and benefits payable | 25,626 | 16,400 |
| Amounts due to governmental entities | 3,211 | 6,023 |
| Income taxes payable | | 10,682 |
| Current portion of long-term debt and capital lease obligations | 427 | 583 |
| Total current liabilities | 46,629 | 49,110 |
| Deferred income taxes | 8,614 | 5,718 |
| Long-term debt, less current portion | 4,180 | 4,483 |
| Other long-term obligations | 66 | 145 |
| Stockholders' equity: | | |
| LHC Group, Inc. stockholders' equity: | | |
| Common stock \$0.01 par value; 40,000,000 shares authorized; 20,947,421 and 20,853,463 shares issued and 17,974,561 and 17,895,832 shares outstanding, respectively | 179 | 179 |
| Treasury stock 2,972,860 and 2,957,631 shares at cost, respectively | (3,402) | (3,072) |

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| | | |
|--|------------|------------|
| Additional paid-in capital | 87,820 | 85,404 |
| Retained earnings | 125,530 | 94,310 |
| Total LHC Group, Inc. stockholders' equity | 210,127 | 176,821 |
| Noncontrolling interest | 13,732 | 7,123 |
| Total equity | 223,859 | 183,944 |
| Total liabilities and equity | \$ 283,348 | \$ 243,400 |

See accompanying notes to the condensed consolidated financial statements.

Table of Contents**LHC GROUP, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF INCOME***(Dollars in thousands, except share and per share data)*

(Unaudited)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|-----------|------------------------------------|------------|
| | 2009 | 2008 | 2009 | 2008 |
| Net service revenue | \$ 132,491 | \$ 97,991 | \$ 389,300 | \$ 271,206 |
| Cost of service revenue | 69,242 | 47,207 | 197,723 | 133,103 |
| Gross margin | 63,249 | 50,784 | 191,577 | 138,103 |
| Provision for bad debts | 1,072 | 3,158 | 4,062 | 10,467 |
| General and administrative expenses | 43,790 | 31,237 | 126,000 | 87,897 |
| Operating income | 18,387 | 16,389 | 61,515 | 39,739 |
| Interest expense | (20) | (132) | (115) | (365) |
| Non-operating (loss) income | 51 | 76 | (337) | 891 |
| Income from continuing operations before income taxes and noncontrolling interests | 18,418 | 16,333 | 61,063 | 40,265 |
| Income tax expense | 5,636 | 5,259 | 18,836 | 12,578 |
| Income from continuing operations | 12,782 | 11,074 | 42,227 | 27,687 |
| Loss from discontinued operations (net of income tax benefit of \$36, \$18, \$124 and \$175, respectively) | 57 | 30 | 211 | 513 |
| Net income | 12,725 | 11,044 | 42,016 | 27,174 |
| Less net income attributable to noncontrolling interests | 2,893 | 3,012 | 10,841 | 7,469 |
| Net income attributable to LHC Group, Inc | 9,832 | 8,032 | 31,175 | 19,705 |
| Redeemable noncontrolling interest | (3) | (29) | 45 | 36 |
| Net income available to LHC Group, Inc. s common stockholders | \$ 9,829 | \$ 8,003 | \$ 31,220 | \$ 19,741 |
| Earnings per share basic: | | | | |
| Income from continuing operations attributable to LHC Group, Inc. | \$ 0.55 | \$ 0.45 | \$ 1.75 | \$ 1.12 |
| Loss from discontinued operations, attributable to LHC Group, Inc. | | | (0.01) | (0.02) |
| Net income attributable to LHC Group, Inc. | 0.55 | 0.45 | 1.74 | 1.10 |
| Redeemable noncontrolling interest | | | | |
| Net income attributable to LHC Group, Inc. s common stockholders | \$ 0.55 | \$ 0.45 | \$ 1.74 | \$ 1.10 |
| Earnings per share diluted: | | | | |
| | \$ 0.54 | \$ 0.45 | \$ 1.74 | \$ 1.12 |

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| | | | | |
|--|------------|------------|------------|------------|
| Income from continuing operations attributable to LHC Group, Inc. | | | | |
| Loss from discontinued operations, attributable to LHC Group, Inc. | | | (0.01) | (0.02) |
| Net income attributable to LHC Group, Inc. | 0.54 | 0.45 | 1.73 | 1.10 |
| Redeemable noncontrolling interest | | | | |
| Net income attributable to LHC Group, Inc.'s common stockholders | \$ 0.54 | \$ 0.45 | \$ 1.73 | \$ 1.10 |
| Weighted average shares outstanding: | | | | |
| Basic | 17,971,352 | 17,881,228 | 17,951,986 | 17,843,869 |
| Diluted | 18,116,984 | 17,976,305 | 18,040,918 | 17,967,488 |
| See accompanying notes to the condensed consolidated financial statements. | | | | |

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(Unaudited)

| | Amount | Common Stock Issued Shares | Common Stock Treasury Amount | Common Stock Treasury Shares | Additional Paid-In Capital | Retained Earnings | Noncontrolling Interest | Total |
|--|--------|----------------------------------|------------------------------------|------------------------------------|----------------------------------|----------------------|----------------------------|------------|
| Balances at December 31, 2008 | \$ 179 | 20,853,463 | \$ (3,072) | (2,957,631) | \$ 85,404 | \$ 94,310 | \$ 7,123 | \$ 183,944 |
| Net income | | | | | | 31,175 | 10,841 | 42,016 |
| Transfer of noncontrolling interest | | | | | 181 | | 1,228 | 1,409 |
| Acquired noncontrolling interest | | | | | | | 5,528 | 5,528 |
| Noncontrolling interest distributions | | | | | | | (10,988) | (10,988) |
| Nonvested stock compensation | | | | | 1,755 | | | 1,755 |
| Issuance of vested restricted stock | | 74,830 | | | | | | |
| Treasury shares redeemed to pay income tax | | | (330) | (15,229) | | | | (330) |
| Excess tax benefits from issuance of vested stock | | | | | 23 | | | 23 |
| Issuance of common stock under Employee Stock Purchase Plan | | 19,128 | | | 457 | | | 457 |
| Recording noncontrolling interest in joint venture at redemption value | | | | | | 45 | | 45 |
| Balances at September 30, 2009 | \$ 179 | 20,947,421 | \$ (3,402) | (2,972,860) | \$ 87,820 | \$ 125,530 | \$ 13,732 | \$ 223,859 |

See accompanying notes to the condensed consolidated financial statements.

Table of Contents**LHC GROUP, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS***(Dollars in thousands)*

(Unaudited)

| | Nine Months Ended September 30, | |
|---|--|------------------|
| | 2009 | 2008 |
| Operating activities | | |
| Net income | \$ 42,016 | \$ 27,174 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization expense | 3,494 | 2,730 |
| Provision for bad debts | 4,141 | 10,820 |
| Stock-based compensation expense | 1,755 | 1,380 |
| Deferred income taxes | 1,692 | 497 |
| Loss on impairment of intangible assets | 542 | |
| Gain on sale of assets | | (343) |
| Changes in operating assets and liabilities, net of acquisitions: | | |
| Receivables | (12,208) | 1,272 |
| Prepaid expenses, income taxes and other assets | (3,613) | 859 |
| Accounts payable and accrued expenses | (1,225) | 11,946 |
| Net amounts due to/from governmental entities | (1,810) | 3,099 |
| Net cash provided by operating activities | 34,784 | 59,434 |
| Investing activities | | |
| Purchases of property, building and equipment | (6,124) | (7,351) |
| Purchase of certificate of deposit | | (522) |
| Proceeds from sale of assets | | 3,094 |
| Cash paid for acquisitions, primarily goodwill and intangible assets | (18,481) | (40,039) |
| Net cash used in investing activities | (24,605) | (44,818) |
| Financing activities | | |
| Proceeds from line of credit | 20,605 | 32,851 |
| Payments on line of credit | (20,605) | (32,851) |
| Payment of deferred financing fees | (263) | (71) |
| Proceeds from debt issuance | | 5,050 |
| Principal payments on debt | (412) | (3,220) |
| Payments on capital leases | (74) | (74) |
| Excess tax benefits from vesting of restricted stock | 98 | 34 |
| Proceeds from employee stock purchase plan | 457 | 385 |
| Noncontrolling interest distributions | (10,988) | (6,724) |
| Net cash used in financing activities | (11,182) | (4,620) |
| Change in cash | (1,003) | 9,996 |
| Cash at beginning of period | 3,511 | 1,155 |
| Cash at end of period | \$ 2,508 | \$ 11,151 |

Supplemental disclosures of cash flow information

| | | |
|-------------------|-----------|----------|
| Interest paid | \$ 115 | \$ 356 |
| Income taxes paid | \$ 31,828 | \$ 8,553 |

Supplemental disclosure of non-cash transactions:

In February 2009, the Company acquired a 75% interest in Southeast Louisiana HomeCare, LLC in exchange for \$7.5 million of cash and a noncontrolling interest in three of the Company's home health agencies. During the nine months ended September 30, 2009, the Company acquired a majority ownership in nine entities and recorded \$6.8 million of noncontrolling interests related to the acquisitions.

See accompanying notes to the condensed consolidated financial statements.

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LHC GROUP, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Organization

LHC Group, Inc. (the Company) is a health care provider specializing in the post-acute continuum of care primarily for Medicare beneficiaries. The Company provides home-based services, primarily through home nursing agencies and hospices, and facility-based services, primarily through long-term acute care hospitals (LTACH). As of the date of this report, the Company, through its wholly and majority-owned subsidiaries, equity joint ventures and controlled affiliates, operated in Louisiana, Mississippi, Arkansas, Alabama, Texas, Virginia, West Virginia, Kentucky, Florida, Georgia, Tennessee, Ohio, Missouri, North Carolina, Maryland, Washington, Oregon and Oklahoma. During the nine months ending September 30, 2009, the Company acquired ten home health agencies, two hospices, one LTACH and initiated operations at ten home health agencies.

In September 2009, the Company sold its outpatient rehabilitation clinic. Therefore, for the three and nine months ended September 30, 2009 and 2008, the operations of the outpatient rehabilitation clinic have been presented as discontinued operations in the condensed consolidated financial statements.

Unaudited Interim Financial Information

The condensed consolidated balance sheet as of September 30, 2009, the related condensed consolidated statements of income for the three and nine months ended September 30, 2009 and 2008, condensed consolidated statement of stockholders' equity as of September 30, 2009, condensed consolidated statements of cash flows for the nine months ended September 30, 2009 and related notes (collectively, these statements are referred to herein as the interim financial information) have been prepared by the Company. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation in accordance with U.S. generally accepted accounting principles (U.S. GAAP) have been included. Operating results for the three and nine months ended September 30, 2009 are not necessarily indicative of the results that may be expected for the year ending December 31, 2009.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. GAAP have been condensed or omitted from the interim financial information presented. This report should be read in conjunction with the Company's consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2008 as filed with the Securities and Exchange Commission (the SEC) on March 16, 2009, which includes information and disclosures not included herein.

The Company evaluated all events or transactions that occurred from September 30, 2009 through November 4, 2009, the date the financial statements were issued. During this period the Company did not have any material recognizable subsequent events.

2. Significant Accounting Policies

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported revenue and expenses during the reporting period. Actual results could differ from those estimates.

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Reclassifications

Certain reclassifications have been made to the 2008 financial information to conform to the 2009 presentation. These reclassifications include \$624,000 and \$1.9 million for the three and nine months ended September 30, 2008, respectively, from cost of service revenue to general and administrative expenses related to payroll taxes for home office employees and local administrative employees at the agencies.

Critical Accounting Policies

The most critical accounting policies relate to the principles of consolidation, revenue recognition and accounts receivable and allowances for uncollectible accounts.

Principles of Consolidation

The condensed consolidated financial statements include all subsidiaries and entities controlled by the Company. Control is defined by the Company as ownership of a majority of the voting interest of an entity. The condensed consolidated financial statements include entities in which the Company receives a majority of the entities' expected residual returns, absorbs a majority of the entities' expected losses, or both, as a result of ownership, contractual or other financial interests in the entity. Third party equity interests in the consolidated joint ventures are reflected as noncontrolling interests in the Company's condensed consolidated financial statements.

The following table summarizes the percentage of net service revenue earned by type of ownership or relationship the Company had with the operating entity:

| | Three Months Ended | | Nine Months Ended | |
|------------------------------|---------------------------|-------------|--------------------------|-------------|
| | September 30, | | September 30, | |
| | 2009 | 2008 | 2009 | 2008 |
| Equity joint ventures | 51.1% | 47.2% | 51.3% | 47.8% |
| Wholly-owned subsidiaries | 44.6% | 48.5% | 44.8% | 48.2% |
| License leasing arrangements | 2.5% | 2.0% | 2.4% | 2.0% |
| Management services | 1.8% | 2.3% | 1.5% | 2.0% |
| | 100.0% | 100.0% | 100.0% | 100.0% |

All significant intercompany accounts and transactions have been eliminated in the Company's accompanying condensed consolidated financial statements. Business combinations accounted for under the acquisition method have been included in the condensed consolidated financial statements from the respective dates of acquisition.

The following describes the Company's consolidation policy with respect to its various ventures excluding wholly-owned subsidiaries.

Equity Joint Ventures

The Company's joint ventures are structured as limited liability companies in which the Company typically owns a majority equity interest ranging from 51% to 99%. The members of the Company's equity joint ventures participate in profits and losses in proportion to their equity interests. The Company consolidates these entities as the Company receives a majority of the entities' expected residual returns, absorbs a majority of the entities' expected losses and generally has voting control over the entity.

License Leasing Arrangements

The Company, through wholly-owned subsidiaries, leases home health licenses necessary to operate certain of its home nursing agencies. As with its wholly-owned subsidiaries, the Company owns 100% of the equity of

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these entities and consolidates them based on such ownership as well as the Company's right to receive a majority of the entities' expected residual returns and the Company's obligation to absorb a majority of the entities' expected losses.

Management Services

The Company has various management services agreements under which the Company manages certain operations of agencies and facilities. The Company does not consolidate these agencies or facilities because the Company does not have an ownership interest and does not have a right to receive a majority of the agencies' or facilities' expected residual returns or an obligation to absorb a majority of the agencies' or facilities' expected losses.

Revenue Recognition

The Company reports net service revenue at the estimated net realizable amount due from Medicare, Medicaid, commercial insurance, managed care payors, patients and others for services rendered. All payors contribute to both the home-based services and facility-based services.

The following table sets forth the percentage of net service revenue earned by category of payor for the three months and nine months ended September 30, 2009 and 2008 was as follows:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|----------|-------------------------------------|--------|------------------------------------|--------|
| | 2009 | 2008 | 2009 | 2008 |
| Payor: | | | | |
| Medicare | 82.4% | 83.2% | 82.7% | 82.9% |
| Medicaid | 3.7% | 4.3% | 3.5% | 4.9% |
| Other | 13.9% | 12.5% | 13.8% | 12.2% |
| | 100.0% | 100.0% | 100.0% | 100.0% |

The percentage of net service revenue contributed from each reporting segment for the three months and nine months ended September 30, 2009 and 2008 was as follows:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|-------------------------|-------------------------------------|--------|------------------------------------|--------|
| | 2009 | 2008 | 2009 | 2008 |
| Home-based services | 88.1% | 86.1% | 88.3% | 84.4% |
| Facility-based services | 11.9% | 13.9% | 11.7% | 15.6% |
| | 100.0% | 100.0% | 100.0% | 100.0% |

*Medicare***Home-Based Services**

Home Nursing Services. The Company's home nursing Medicare patients are classified into one of 153 home health resource groups prior to receiving services. Based on this home health resource group, the Company is entitled to receive a standard prospective Medicare payment for delivering care over a 60-day period referred to as an episode. The Company recognizes revenue based on the number of days elapsed during an episode of care within the reporting period.

Final payments from Medicare may reflect one of four retroactive adjustments to ensure the adequacy and effectiveness of the total reimbursement: (a) an outlier payment if the patient's care was unusually costly; (b) a low utilization adjustment if the number of visits was fewer

than five; (c) a partial payment if the patient

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transferred to another provider before completing the episode; or (d) a payment adjustment based upon the level of therapy services required in the population base. Management estimates the impact of these payment adjustments based on historical experience and records this estimate during the period the services are rendered. The Company's payment is also adjusted for differences in local prices using the hospital wage index. In calculating the Company's reported net service revenue from home nursing services, the Company adjusts the prospective Medicare payments by an estimate of the adjustments. The adjustments are calculated using a historical average of prior adjustments. The Company performs payment variance analyses to verify that the models utilized in projecting total net service revenue are accurately reflecting the payments to be received.

Hospice Services. The Company is paid by Medicare under a per diem payment system. The Company receives one of four predetermined daily or hourly rates based upon the level of care the Company furnished. The Company records net service revenue from hospice services based on the daily or hourly rate and recognizes revenue as hospice services are provided.

Hospice payments are also subject to an inpatient cap and an overall payment cap. Inpatient cap relates to individual programs receiving more than 20% of its total Medicare reimbursement from inpatient care services and the overall payment cap relates to individual programs receiving reimbursements in excess of a cap amount, calculated by multiplying the number of beneficiaries during the period by a statutory amount that is indexed for inflation. The determination for each cap is made annually based on the 12-month period ending on October 31 of each year. We monitor our limits on a program-by-program basis. We have not received notification that any of our hospices have exceeded the cap on inpatient care services during 2008 or 2009 to date.

Management Services. The Company records management services revenue as services are provided in accordance with the various management services agreements to which the Company is a party. As described in the agreements, the Company provides billing, management and other consulting services suited to and designed for the efficient operation of the applicable home nursing agency or inpatient rehabilitation facility. The Company is responsible for the costs associated with the locations and personnel required for the provision of services. The Company is compensated based on a percentage of cash collections or is reimbursed for operating expenses and compensated based on a percentage of operating net income.

Facility-Based Services

Long-Term Acute Care Services (LTACHs). The Company is reimbursed by Medicare for services provided under LTACH prospective payment system, which was implemented on October 1, 2002. Each patient is assigned a long-term care diagnosis-related group. The Company is paid a predetermined fixed amount intended to reflect the average cost of treating a Medicare patient classified in that particular long-term care diagnosis-related group. For selected patients, the amount may be further adjusted based on length of stay and facility-specific costs, as well as in instances where a patient is discharged and subsequently re-admitted, among other factors. Similar to other Medicare prospective payment systems, the rate is also adjusted for geographic wage differences. The Company calculates the adjustment based on a historical average of these types of adjustments for claims paid. Revenue is recognized for the Company's LTACHs as services are provided.

Medicaid, managed care and other payors

The Company's Medicaid reimbursement is based on a predetermined fee schedule applied to each service provided. Therefore, revenue is recognized for Medicaid services as services are provided based on this fee schedule. The Company's managed care payors reimburse the Company in a manner similar to either Medicare or Medicaid. Accordingly, the Company recognizes revenue from managed care payors in the same manner as the Company recognizes revenue from Medicare or Medicaid.

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Accounts Receivable and Allowances for Uncollectible Accounts

The Company reports accounts receivable net of estimated allowances for uncollectible accounts and adjustments. Accounts receivable are uncollateralized and primarily consist of amounts due from Medicare, other third-party payors, and patients. To provide for accounts receivable that could become uncollectible in the future, the Company establishes an allowance for uncollectible accounts to reduce the carrying amount of such receivables to their estimated net realizable value. The credit risk for other concentrations of receivables is limited due to the significance of Medicare as the primary payor. We believe the credit risk associated with our Medicare accounts, which represent 73.9% and 75.3% of our patient accounts receivable at September 30, 2009 and December 31, 2008, respectively, is limited due to (i) our historical collection rate of over 98% from Medicare and (ii) the fact that Medicare is a U.S. government payor. The Company does not believe that there are any other significant concentrations of receivables from any particular payor that would subject it to any significant credit risk in the collection of accounts receivable.

The amount of the provision for bad debts is based upon the Company's assessment of historical and expected net collections, business and economic conditions and trends in government reimbursement. Uncollectible accounts are written off when the Company has determined the account will not be collected.

A portion of the estimated Medicare prospective payment system reimbursement from each submitted home nursing episode is received in the form of a request for anticipated payment (RAP). The Company submits a RAP for 60% of the estimated reimbursement for the initial episode at the start of care. The full amount of the episode is billed after the episode has been completed. The RAP received for that particular episode is deducted from the final payment. If a final bill is not submitted within the greater of 120 days from the start of the episode, or 60 days from the date the RAP was paid, any RAPs received for that episode will be recouped by Medicare from any other Medicare claims in process for that particular provider. The RAP and final claim must then be resubmitted. For subsequent episodes of care contiguous with the first episode for a particular patient, the Company submits a RAP for 50% instead of 60% of the estimated reimbursement. The Company has earned net service revenue in excess of billings rendered to Medicare.

Our Medicare population is paid at a prospectively set amount that can be determined at the time services are rendered. Our Medicaid reimbursement is based on a predetermined fee schedule applied to each individual service we provide. Our managed care contracts are structured similar to either the Medicare or Medicaid payment methodologies. Because of our payor mix, we are able to calculate our actual amount due at the patient level and adjust the gross charges down to the actual amount at the time of billing. This negates the need for an estimated contractual allowance to be booked at the time we report net service revenue for each reporting period.

Other Significant Accounting Policies

Adoption of New Accounting Standards

In June 2009, the Financial Accounting Standards Board (the FASB) issued Accounting Standards Update 2009-01, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles – a replacement of FASB Statement No. 162* (SFAS 168). The *FASB Accounting Standards Codification* (Codification) is the source of authoritative U.S. GAAP recognized by the FASB to be applied by nongovernmental entities. Its primary purpose is to improve clarity and use of existing standards by grouping authoritative literature under common topics. The FASB will no longer issue new standards in the form of Statements, FASB Staff Positions or Emerging Issues Task Force Abstracts. Instead, it will issue Accounting Standards Updates which will serve to update the Codification, provide background information about the guidance and provide the basis for conclusions on the changes to the Codification. This Statement is effective for financial statements issued for interim and annual periods ending after September 15, 2009. To conform to the provisions of ASU 2009-01, the Company will also reference the Accounting Standards Codification (ASC) that replaces the previous standard reference. The Codification does not change or alter existing GAAP and did not have a material effect on the Company's condensed financial condition, results of operations, or cash flows.

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In April 2009, the FASB issued FASB Staff Position (FSP) FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments*. The FSP amends SFAS 107, *Disclosures about Fair Value of Financial Instruments*, and Accounting Principles Board Opinion No. 28, *Interim Financial Reporting* (ASC Topic 820-10-50). The guidance requires publicly-traded entities to disclose in the body or in the accompanying notes of its summarized financial information for interim reporting periods and in its financial statements for annual reporting periods, the fair value of all financial instruments for which it is practicable to estimate that value, whether recognized or not recognized in the statement of financial position, as required by other authoritative guidance. The guidance is effective for interim and annual reporting periods ending after June 15, 2009. The adoption of the new disclosure requirements did not have a material effect on the Company's condensed financial condition, results of operations, or cash flows.

In May 2009, the Company adopted the provisions of FASB Statement No. 165, *Subsequent Events* (ASC Topic 855), which establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. In particular, the Statement sets forth the period after the balance sheet date during which management of the Company should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, the circumstances under which the Company should recognize events or transactions occurring after the balance sheet date in its financial statements, and the disclosures that the Company should make about events or transactions that occurred after the balance sheet date. Because the guidance only introduces the concept of financial statements being *available to be issued*, adoption of this Statement did not result in significant changes in the subsequent events that the Company reports, either through recognition or disclosure, in its consolidated financial statements.

On January 1, 2009, the Company prospectively adopted the provisions of FASB Statement No. 141 (Revised 2007), *Business Combinations* (ASC Topic 805). The authoritative guidance changes the accounting treatment and disclosure for certain specific items in a business combination. According to the guidance, an acquiring entity is required to recognize all the assets acquired and liabilities assumed in a transaction at the acquisition-date fair value with limited exceptions. This includes the fair values of the noncontrolling interest acquired. Under previous guidance, the noncontrolling interest (minority interest) was recorded at the minority owner's historical balance. Other changes include the treatment of acquisition-related costs, which, with the exception of debt or equity issuance costs, are to be recognized as an expense in the period that the costs are incurred and the services are received. The Company capitalized acquisition-related costs under previous guidance. Further, any adjustments during the measurement period to the provisional amounts recognized as part of the purchase price allocation are treated retrospectively as of the acquisition date.

In April 2009, the FASB issued FSP No. FAS 141(R)-1, *Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies* (ASC Topic 805-20). The update addresses application issues on initial recognition and measurement, subsequent measurement and accounting, and disclosure of assets and liabilities arising from contingencies in a business combination. The update required that all contractual contingencies and all noncontractual contingencies that are more likely than not to give rise to an asset or liability be recognized at their acquisition date fair value. All noncontractual contingencies that do not meet the more-likely-than not criterion as of the acquisition date would be accounted for in accordance with other U.S. GAAP. The guidance requires that when new information is obtained, a liability be measured at the higher of its acquisition-date fair value and the amount that would be recognized under other authoritative guidance. Further, an acquirer shall recognize at fair value, at the acquisition date, an asset acquired or a liability assumed in a business combination that arises from a contingency if the acquisition-date fair value of that asset or liability can be determined during the measurement period. The Company has adopted the provisions of this guidance effective January 1, 2009, and does not anticipate adoption will have a material effect on the operating results, financial position, or liquidity of the Company.

The Company also adopted the provisions of SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements – An Amendment of ARB No. 51* (ASC Topic 810-10-65) on January 1, 2009. The guidance establishes new accounting and reporting standards for the noncontrolling interest, previously known as

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minority interest. Noncontrolling interest in consolidated subsidiaries is presented in the consolidated balance sheet within stockholders' equity as a separate component from the parent's equity. Consolidated net income includes earnings attributable to both the parent and the noncontrolling interest. Earnings per share, which is not affected by the guidance, is based on earnings attributable only to the parent company. The guidance explains the accounting for changes in the parent's ownership interest in a subsidiary, including transactions where control is retained and where control is relinquished. The guidance requires additional disclosure information related to amounts attributable to the parent for income from continuing operations, discontinued operations and extraordinary items and reconciliations of the parent and noncontrolling interests' equity in subsidiaries.

Earnings Per Share

Earnings per share are computed in accordance with Statement of Financial Accounting Standards (SFAS) No. 128, *Earnings Per Share* (ASC 260). Basic per share information is computed by dividing the relevant amounts from the condensed consolidated statements of income by the weighted-average number of shares outstanding during the period. Diluted per share information is computed, using the treasury stock method, by dividing the relevant amounts from the condensed consolidated statements of income by the weighted-average number of shares outstanding plus dilutive potential shares.

The following table sets forth shares used in the computation of basic and diluted per share information:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|------------|------------------------------------|------------|
| | 2009 | 2008 | 2009 | 2008 |
| Weighted average number of shares outstanding for basic per share calculation | 17,971,352 | 17,881,228 | 17,951,986 | 17,843,869 |
| Effect of dilutive potential shares: | | | | |
| Options | 6,001 | 6,256 | 5,820 | 5,111 |
| Nonvested stock | 105,630 | 88,821 | 49,111 | 118,508 |
| Contingent Shares | 34,001 | | 34,001 | |
| Adjusted weighted average shares for diluted per share calculation | 18,116,984 | 17,976,305 | 18,040,918 | 17,967,488 |

3. Acquisitions and Disposals

Pursuant to the Company's strategy for becoming the leading provider of post-acute health care services in the United States, the Company acquired one LTACH, ten homecare entities and two hospice entities during the nine months ended September 30, 2009. As a result of the acquisitions, the Company maintains an ownership interest in the entities set forth below. The Company's ownership percentages and the state of operations are in parentheses:

Southeast Louisiana HomeCare, LLC (75%, Louisiana)

Louisiana Extended Care Hospital of Kenner, LLC (75%, Louisiana)

Hospice of Central Arkansas, LLC (67%, Arkansas)

Marion Regional HomeCare, LLC (67%, Alabama)

Washington HomeCare and Hospice of Central Basin, LLC (100%, Washington)

East Alabama Medical Center HomeCare, LLC (75%, Alabama)

Kentucky HomeCare of Henderson, LLC (67%, Kentucky)

Northeast Washington Home Health, Inc. (80.1%, Washington)

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Coosa Valley HomeCare, LLC (75%, Alabama)

Three Rivers HomeCare, LLC (75%, Oregon)

LHCG XV, LLC (100%, Louisiana)

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The total purchase price of the acquisitions was \$18.6 million, which was paid primarily in cash. The purchase price for Southeast Louisiana Homecare, LLC included a transfer of 25% noncontrolling interest in three of the Company's wholly owned home health agencies. The purchase prices were determined based on the Company's analysis of comparable acquisitions and the target market's potential future cash flows. In accordance with authoritative guidance, the transfer of a noncontrolling interest in three of the Company's existing home health agencies as part of the consideration paid for Southeast Louisiana HomeCare, LLC was accounted for as an equity transaction, resulting in the Company recognizing additional paid in capital of \$181,000.

The Company recognized goodwill of \$15.5 million, including \$3.5 million of noncontrolling goodwill, related to the acquisitions. The Company expects its portion of goodwill to be fully tax deductible. Goodwill was assigned to the home-based segment and the facility based segment in the amounts of \$15.1 million and \$455,000, respectively.

The following table summarizes the consideration paid for the acquisitions and the amounts of the assets acquired and liabilities assumed at the acquisition dates, as well as the fair value at the acquisition dates of the noncontrolling interest acquired.

| | |
|--|------------------|
| Consideration (in thousands) | |
| Cash | \$ 17,238 |
| Equity instruments (the Company exchanged a noncontrolling ownership interest in three of its entities) | 1,409 |
| Fair value of total consideration transferred | \$ 18,647 |
| Acquisition-related costs (included in general and administrative expenses in the Company's statements of income for the nine months ending September 30, 2009) | \$ 643 |
| Recognized amounts of identifiable assets acquired and liabilities assumed | |
| Property, plant and equipment | \$ 285 |
| Trade name | 6,368 |
| Certificate of need/License | 1,617 |
| Other identifiable intangible assets | 400 |
| Total identifiable assets | \$ 8,670 |
| Noncontrolling interest | \$ 5,527 |
| Goodwill, including noncontrolling interest of (\$3.5 million) | \$ 15,504 |

The fair value of the acquired intangible assets is preliminary pending receipt of the final valuations of those assets.

In 2008, one of the Company's acquisitions contained contingent consideration to the seller that may be settled in shares of the Company's stock one year after the acquisition date. The number of shares that may be issued is contingent upon the acquired Company achieving certain financial measurements in the year after the acquisition. During the three months ended September 30, 2009, the Company recorded \$1.9 million of additional purchase price related to the contingent consideration as the Company achieved the required financial measurements. \$950,000 of the additional purchase price was paid in cash and the remaining \$950,000 is recorded as a liability as the number of the shares cannot be determined until they are issued during the first quarter of 2010.

One of the acquisitions during 2008 included operations which are not core to the operations of the Company. During the first quarter of 2009, the Company began marketing these operations and intends to sell them within the next twelve months. The Company allocated \$450,000 to home-based services goodwill related to the non-core operations. As of September 30, 2009, the Company determined that the plan of sale criteria in SFAS No. 144, *Accounting for the Impairment of Disposal of Long-Lived Assets*, (ASC Topic 205-20-45) has

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been met, and accordingly, the Company has classified \$450,000 as assets held for sale on the consolidated balance sheet as of September 30, 2009. The operations for the nine months ended September 30, 2009 are included in loss from discontinued operations.

During the nine months ended September 30, 2009, the Company settled the working capital amounts acquired on several of the 2008 acquisitions. An additional \$293,000 was paid in cash on 2008 acquisitions related to the settlements. An additional \$750,000 was recognized as goodwill and a deferred tax liability related to the settlement of the working capital.

In September 2009, the Company sold its outpatient rehabilitation clinic. The sale generated a loss of \$23,000, which was recognized in the third quarter of 2009. The results of operations related to the clinic are included in discontinued operations in the Company's condensed consolidated statements of income.

The following table provides financial results of discontinued operations for the three months and nine months ended September 30, 2009 and 2008:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|---|-------------|--|-------------|
| | 2009 | 2008 | 2009 | 2008 |
| Net service revenue | \$ 454 | \$ 176 | \$ 1,507 | \$ 493 |
| Costs of services and G&A expenses | (547) | (224) | (1,842) | (1,181) |
| Loss from discontinued operations before noncontrolling interest and income taxes | (93) | (48) | (335) | (688) |
| Income tax benefit | 36 | 18 | 124 | 175 |
| Loss from discontinued operations net of income tax benefit | (57) | 30 | (211) | (513) |
| Less loss from discontinued operations attributable to noncontrolling interest | 0 | 0 | 0 | (241) |
| Loss from discontinued operations attributable to LHC Group Inc.'s common stockholders | \$ (57) | \$ (30) | \$ (211) | \$ (272) |

4. Goodwill and Intangibles

The changes in recorded goodwill by segment for the nine months ended September 30, 2009 were as follows:

| | Nine Months Ended September 30, 2009 (in thousands) |
|---|--|
| Home-based services segment: | |
| Balance at December 31, 2008 | \$ 107,108 |
| Goodwill from acquisitions | 11,745 |
| Goodwill related to noncontrolling interest | 3,304 |
| 2008 acquisition adjustments | 204 |
| Settlement of 2008 acquisition payments | 2,440 |
| Goodwill classified as held for sale | (450) |
| Balance at September 30, 2009 | \$ 124,351 |
| Facility-based services segment: | |
| Balance at December 31, 2008 | \$ 5,464 |
| Goodwill from acquisitions | 299 |
| Goodwill related to noncontrolling interest | 156 |

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| | | |
|--|----|---------|
| Goodwill acquired from redemption of noncontrolling interest | | 15 |
| Balance at September 30, 2009 | \$ | 5,934 |
| Consolidated balance at September 30, 2009 | \$ | 130,285 |

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In 2008, the Company purchased two home health agency provider numbers in Ohio for \$542,000 and obtained approval from the State of Ohio to move the provider numbers to a new service area. In February 2009, the Centers for Medicare and Medicaid Services (CMS) denied the Company's change of ownership for the provider numbers because the agency locations were moved outside of the allowed service area. Although the Company has re-applied for and received the new provider numbers for these home health agencies, the purchased provider numbers no longer have value. Therefore, the Company has recognized a \$542,000 impairment expense in other non-operating (loss) income on the Company's Condensed Consolidated Statements of Income for the nine months ended September 30, 2009.

The following table summarizes the changes in intangible assets during nine months ended September 30, 2009.

| | Trade Names | Certificate of Need/License | Other Intangibles | Total |
|--------------------------------------|-------------|-----------------------------------|----------------------|-----------|
| Balance at December 31, 2008 | \$ 27,233 | \$ 2,001 | \$ 741 | \$ 29,975 |
| Additions | 6,368 | 1,617 | 400 | 8,385 |
| 2008 Acquisition Adjustments | 119 | 542 | | 661 |
| License Impairment | | (542) | | (542) |
| Amortization | | | (354) | (354) |
| Balance at September 30, 2009 | \$ 33,720 | \$ 3,618 | \$ 787 | \$ 38,125 |

Other intangible assets of \$37.2 million, net of accumulated amortization, related to the home-based services segment and \$922,000 related to the facility-based services segment as of September 30, 2009.

5. Credit Arrangements

The Company's Credit Facility with Capital One, National Association, which was amended on June 19, 2009, provides for a maximum aggregate principal borrowing of \$75.0 million. The Credit Facility, which is scheduled to expire on June 10, 2012, is unsecured and has a letter of credit sublimit of \$2.5 million. In September 2009, the Company issued a \$700,000 letter of credit as collateral on the Company's workers compensation insurance. The annual facility fee is 0.25% of the total availability. The interest rate for borrowings under the Credit Facility is a function of the prime rate (Base Rate) subject to a floor or the Eurodollar rate (Eurodollar) subject to a floor, as elected by the Company, plus the applicable margin based on the Leverage Ratio as defined in the Credit Facility. Other than the letter of credit, no amounts were outstanding on this facility at September 30, 2009.

The Company's Credit Facility contains customary affirmative, negative and financial covenants. For example, the Company is restricted in incurring additional debt, disposing of assets, making investments, allowing fundamental changes to the Company's business or organization, and making certain payments in respect of stock or other ownership interests, such as dividends and stock repurchases. Under the Credit Facility, the Company is also required to meet certain financial covenants with respect to minimum fixed charge coverage, consolidated net worth, leverage and minimum asset coverage ratios. At September 30, 2009, the Company was in compliance with all covenants.

The Company's Credit Facility also contains customary events of default. These include bankruptcy and other insolvency events, cross-defaults to other debt agreements, a change in control involving the Company or any subsidiary guarantor, and the failure to comply with certain covenants.

Table of Contents**6. Stockholders' Equity****Share Based Compensation**

On January 20, 2005, the board of directors and stockholders of the Company approved the 2005 Long Term Incentive Plan (the Incentive Plan). The Incentive Plan provides for 1,000,000 shares of common stock that may be issued or transferred pursuant to awards made under the plan. A variety of discretionary awards for employees, officers, directors and consultants are authorized under the Incentive Plan, including incentive or non-qualified statutory stock options and nonvested stock. All awards must be evidenced by a written award certificate which will include the provisions specified by the compensation committee of the board of directors. The compensation committee will determine the exercise price for non-statutory stock options. The exercise price for any option cannot be less than the fair market value of our common stock as of the date of grant.

Also on January 20, 2005, the 2005 Director Compensation Plan was adopted. The shares issued under our 2005 Director Compensation Plan are issued from the 1,000,000 shares reserved for issuance under our Incentive Plan.

Stock Options

As of September 30, 2009, 19,000 options were issued and exercisable. During the nine months ended September 30, 2009 and 2008, no options were exercised, forfeited or granted.

Nonvested Stock

During the nine months ended September 30, 2009, 14,000 nonvested shares of stock were granted to our independent directors under the 2005 Director Compensation Plan. All of these shares vest one year from the grant date. During the nine months ended September 30, 2009, 220,483 nonvested shares were granted to employees pursuant to the Incentive Plan. All of these shares vest over a five year period. The fair value of nonvested shares is determined based on the closing trading price of the Company's shares on the grant date. The weighted average grant date fair value of nonvested shares granted during the nine months ended September 30, 2009 was \$19.93.

The following table represents the nonvested stock activity for the nine months ended September 30, 2009:

| | Number of Shares | Weighted average grant date fair value |
|---|-----------------------------|---|
| Nonvested shares outstanding at December 31, 2008 | 306,406 | \$ 22.45 |
| Granted | 234,483 | \$ 19.93 |
| Vested | (74,830) | \$ 21.06 |
| Forfeited | (5,848) | \$ 19.40 |
| Nonvested shares outstanding at September 30, 2009 | 460,211 | \$ 21.65 |

As of September 30, 2009, there was \$7.6 million of total unrecognized compensation cost related to nonvested shares granted. That cost is expected to be recognized over the weighted average period of 3.5 years. The total fair value of shares vested in the nine months ended September 30, 2009 and 2008 was \$1.6 million and \$1.0 million, respectively. The Company records compensation expense related to nonvested share awards at the grant date for shares that are awarded fully vested, and over the vesting term on a straight line basis for shares that vest over time. The Company has recorded \$1.8 million and \$1.4 million of compensation expense related to nonvested stock grants in the nine months ended September 30, 2009 and 2008, respectively.

Employee Stock Purchase Plan

The Company has a plan whereby eligible employees may purchase the Company's common stock at 95 percent of the market price on the last day of the calendar quarter. There are 250,000 shares reserved for the plan.

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The Company issued 4,076 shares of common stock under the plan at a per share price of \$34.20 during the three months ended March 31, 2009, 6,420 shares of common stock under the plan at a per share price of \$21.17 during the three months ended June 30, 2009 and 8,632 shares of common stock under the plan at a per share price of \$21.10 during the three months ended September 30, 2009. As of September 30, 2009 there were 183,895 shares available for future issuance.

7. Commitments and Contingencies

Contingencies

The Company is involved in various legal proceedings arising in the ordinary course of business. Although the results of litigation cannot be predicted with certainty, management believes the outcome of pending litigation will not have a material adverse effect, after considering the effect of the Company's insurance coverage, on the Company's consolidated financial statements.

Joint Venture Buy/Sell Provisions

Several of the Company's joint ventures include a buy/sell option that grants to us and our joint venture partner(s) the right to require the other joint venture party to either purchase all of the exercising member's membership interests or sell to the exercising member all of the non-exercising member's membership interest, at the non-exercising member's option, within 30 days of the receipt of notice of the exercise of the buy/sell option. In some instances, the purchase price is based on a multiple of the historical or future earnings before income taxes and depreciation and amortization of the equity joint venture at the time the buy/sell option is exercised. In other instances, the buy/sell purchase price will be negotiated by the partners and subject to a fair market valuation process. The Company has not received notice from any joint venture partners of their intent to exercise the terms of the buy/sell agreement nor has the Company notified any joint venture partners of its intent to exercise the terms of the buy/sell agreement.

Compliance

The laws and regulations governing the Company's operations, along with the terms of participation in various government programs, regulate how the Company does business, the services offered and its interactions with patients and the public. These laws and regulations and their interpretations, are subject to frequent change. Changes in existing laws or regulations, or their interpretations, or the enactment of new laws or regulations could materially and adversely affect the Company's operations and financial condition.

The Company is subject to various routine and non-routine governmental reviews, audits and investigations. In recent years, federal and state civil and criminal enforcement agencies have heightened and coordinated their oversight efforts related to the health care industry, including referral practices, cost reporting, billing practices, joint ventures and other financial relationships among health care providers. Violation of the laws governing the Company's operations, or changes in the interpretation of those laws, could result in the imposition of fines, civil or criminal penalties, termination of the Company's rights to participate in federal and state-sponsored programs and suspension or revocation of the Company's licenses.

If the Company's LTACHs fail to meet or maintain the standards for Medicare certification as long-term acute care hospitals, such as average minimum length of patient stay, they will receive payments under the prospective payment system applicable to general acute care hospitals rather than payment under the system applicable to LTACHs. Payments at rates applicable to general acute care hospitals would likely result in the Company receiving less Medicare reimbursement than currently received for patient services. Moreover, all but one of the Company's LTACHs are subject to additional Medicare criteria because they operate as separate hospitals located in space leased from, and located in, a general acute care hospital, known as a "host hospital". This is known as the "hospital within a hospital" model. These additional criteria include requirements concerning financial and operational separateness from the host hospital.

The Company anticipates there may be changes to the standard episode-of-care payment from Medicare in the future. Due to the uncertainty of the revised payment amount, the Company cannot estimate the effect that changes in the payment rate, if any, will have on its future financial statements.

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The Company believes that it is in material compliance with all applicable laws and regulations. On July 13, 2009, the Company filed a Current Report on Form 8-K regarding an administrative subpoena from the Inspector General of the Office of Personnel Management (OPM). OPM is an administrative agency responsible for overseeing the Federal Employees Health Benefit Program (FEHBP). Although the subpoena was issued by OPM and the Company understood the subpoena and the OPM 's review to be limited to the FEHBP, the Company learned on July 9, 2009 that the scope of the review is not limited to the FEHBP, but also extends to services provided to Medicare beneficiaries. At this time there is no clear indication from OPM as to the scope or purpose of the review other than a focus on third-party quality improvement audits performed on the Company 's behalf from 2005 to present. The Company will continue to cooperate and provide responsive information for the OPM review.

On April 14, 2009, the Company filed a Current Report on Form 8-K regarding a qui tam lawsuit filed in Tennessee entitled United States of America ex rel Sally Christine Summers v. LHC Group, Inc. claiming a violation of the False Claims Act at a single agency. On June 11, 2009, the Company filed a Current Report on Form 8-K, reporting the district court 's order dismissing the case. Summers ' counsel is now appealing the court 's dismissal, and the Company continues to respond as necessary and appropriate.

Except as discussed in the preceding paragraph, the Company is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. While no such regulatory inquiries have been made, compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action, including fines, penalties and exclusion from the Medicare program.

8. Fair Value of Financial Instruments

The carrying amounts of the Company 's cash, receivables, accounts payable and accrued liabilities approximate their fair values because of their short maturity. The carrying value of the Company 's long-term debt equals its fair value based on a variable interest rate.

9. Segment Information

The Company 's segments consist of home-based services and facility-based services. Home-based services include home nursing services and hospice services. Facility-based services include long-term acute care services. The accounting policies of the segments are the same as those described in the summary of significant accounting policies.

| | Three Months Ended September 30, 2009 | | |
|---|--|---|-------------------|
| | Home-Based Services | Facility-Based Services (in thousands) | Total |
| Net service revenue | \$ 116,746 | \$ 15,745 | \$ 132,491 |
| Cost of service revenue | 59,621 | 9,621 | 69,242 |
| Provision for bad debts | 1,232 | (160) | 1,072 |
| General and administrative expenses | 39,258 | 4,532 | 43,790 |
| Operating income | 16,635 | 1,752 | 18,387 |
| Interest expense | (18) | (2) | (20) |
| Non-operating income | 45 | 6 | 51 |
| Income from continuing operations before income taxes and noncontrolling interest | 16,662 | 1,756 | 18,418 |
| Noncontrolling interest | 2,719 | 174 | 2,893 |
| Income from continuing operations before income taxes | \$ 13,943 | \$ 1,582 | \$ 15,525 |
| Total assets | \$ 256,942 | \$ 26,406 | \$ 283,348 |

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| | Three Months Ended September 30, 2008 | | |
|---|---------------------------------------|--|---------------|
| | Home-Based Services | Facility-Based Services (in thousands) | Total |
| Net service revenue | \$ 84,514 | \$ 13,477 | \$ 97,991 |
| Cost of service revenue | 39,385 | 7,822 | 47,207 |
| Provision for bad debts | 2,759 | 399 | 3,158 |
| General and administrative expenses | 28,227 | 3,010 | 31,237 |
| Operating income | 14,143 | 2,246 | 16,389 |
| Interest expense | (113) | (19) | (132) |
| Non-operating income | 58 | 18 | 76 |
| Income from continuing operations before income taxes and noncontrolling interest | 14,088 | 2,245 | 16,333 |
| Noncontrolling interest | 2,754 | 258 | 3,012 |
| Income from continuing operations before income taxes | \$ 11,334 | \$ 1,987 | \$ 13,321 |
| Total assets | \$ 194,672 | \$ 21,893 | \$ 216,565 |

| | Nine Months Ended September 30, 2009 | | |
|---|--------------------------------------|--|---------------|
| | Home-Based Services | Facility-Based Services (in thousands) | Total |
| Net service revenue | \$ 343,702 | \$ 45,598 | \$ 389,300 |
| Cost of service revenue | 170,583 | 27,140 | 197,723 |
| Provision for bad debts | 4,068 | (6) | 4,062 |
| General and administrative expenses | 114,124 | 11,876 | 126,000 |
| Operating income | 54,927 | 6,588 | 61,515 |
| Interest expense | (104) | (11) | (115) |
| Non-operating income (loss) | (365) | 28 | (337) |
| Income from continuing operations before income taxes and noncontrolling interest | 54,458 | 6,605 | 61,063 |
| Noncontrolling interest | 9,820 | 1,021 | 10,841 |
| Income from continuing operations before income taxes | \$ 44,638 | \$ 5,584 | \$ 50,222 |
| Total assets | \$ 256,942 | \$ 26,406 | \$ 283,348 |

| | Nine Months Ended September 30, 2008 | | |
|-------------------------------------|--------------------------------------|--|------------|
| | Home-Based Services | Facility-Based Services (in thousands) | Total |
| Net service revenue | \$ 229,296 | \$ 41,910 | \$ 271,206 |
| Cost of service revenue | 109,145 | 23,958 | 133,103 |
| Provision for bad debts | 9,090 | 1,377 | 10,467 |
| General and administrative expenses | 77,508 | 10,389 | 87,897 |

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| | | | |
|---|------------|-----------|------------|
| Operating income | 33,553 | 6,186 | 39,739 |
| Interest expense | (276) | (89) | (365) |
| Non-operating income | 703 | 188 | 891 |
| Income from continuing operations before income taxes and noncontrolling interest | 33,980 | 6,285 | 40,265 |
| Noncontrolling interest | 6,471 | 1,239 | 7,710 |
| Income from continuing operations before income taxes | 27,509 | 5,046 | 32,555 |
| Total assets | \$ 194,672 | \$ 21,893 | \$ 216,565 |

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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
CAUTIONARY NOTICE REGARDING FORWARD-LOOKING STATEMENTS**

This Management's Discussion and Analysis of Financial Condition and Results of Operations contains certain statements and information that may constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1993, as amended and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). Forward-looking statements relate to future plans and strategies, anticipated events or trends, future financial performance and expectations and beliefs concerning matters that are not historical facts or that necessarily depend upon future events. The words may, will, should, could, would, expect, plan, intend, anticipate, believe, estimate, potential or other similar expressions are intended to identify forward-looking statements. Specifically, this report contains, among others, forward-looking statements about:

our expectations regarding financial condition or results of operations for periods after September 30, 2009;

our critical accounting policies;

our business strategies and our ability to grow our business;

our participation in the Medicare and Medicaid programs;

the impact of the President's budget proposal;

the reimbursement levels of Medicare and other third-party payors;

the prompt receipt of payments from Medicare and other third-party payors;

our future sources of and needs for liquidity and capital resources;

the effect of any changes in market rates on our operations and cash flows;

our ability to obtain financing;

our ability to make payments as they become due;

the outcomes of various routine and non-routine governmental reviews, audits and investigations;

our expansion strategy, the successful integration of recent acquisitions and, if necessary, the ability to relocate or restructure our current facilities;

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the value of our proprietary technology;

the impact of legal proceedings;

our insurance coverage;

the costs of medical supplies;

our competitors and our competitive advantages;

the price of our stock;

our compliance with environmental, health and safety laws and regulations;

our compliance with health care laws and regulations;

our compliance with Securities and Exchange Commission laws and regulations and Sarbanes-Oxley requirements;

the impact of federal and state government regulation on our business; and

the impact of changes in our future interpretations of fraud, anti-kickbacks or other laws.

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The forward-looking statements contained in this report reflect our current views about future events and are based on assumptions and are subject to known and unknown risks and uncertainties. Many important factors could cause actual results or achievements to differ materially from any future results or achievements expressed in or implied by our forward-looking statements. Many of the factors that will determine future events or achievements are beyond our ability to control or predict. Important factors that could cause actual results or achievements to differ materially from the results or achievements reflected in our forward-looking statements include, among other things, the factors discussed in the Part II, Item 1A. Risk Factors, included in this report and in other of our filings with the SEC, including our annual report on Form 10-K for the year ended December 31, 2008. This report should be read in conjunction with that annual report on Form 10-K, and all our other filings, including quarterly reports on Form 10-Q and current reports on Form 8-K made with the SEC through the date of this report.

You should read this report, the information incorporated by reference into this report and the documents filed as exhibits to this report completely and with the understanding that our actual future results or achievements may be materially different from what we expect or anticipate.

The forward-looking statements contained in this report reflect our views and assumptions only as of the date this report is signed. Except as required by law, we assume no responsibility for updating any forward-looking statements.

We qualify all of our forward-looking statements by these cautionary statements. In addition, with respect to all of our forward-looking statements, we claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995.

Unless the context otherwise requires, we, us, our, and the Company refer to LHC Group, Inc. and its consolidated subsidiaries.

OVERVIEW

We provide post-acute health care services, through our home nursing agencies, hospices and long-term acute care hospitals. Our founders began operations in 1994 with one home nursing agency in Palmetto, Louisiana. Since then, we have grown to 269 service providers in 18 states: Louisiana, Mississippi, Arkansas, Alabama, Texas, Virginia, West Virginia, Kentucky, Florida, Georgia, Tennessee, Ohio, Missouri, North Carolina, Maryland, Washington, Oregon and Oklahoma as of September 30, 2009.

Segments

We operate in two segments for financial reporting purposes: home-based services and facility-based services. The percentage of net service revenue contributed from each reporting segment for the three months and nine months ended September 30, 2008 and 2009 was as follows:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|-------------------------|-------------------------------------|--------|------------------------------------|--------|
| | 2009 | 2008 | 2009 | 2008 |
| Home-based services | 88.1% | 86.1% | 88.3% | 84.4% |
| Facility-based services | 11.9% | 13.9% | 11.7% | 15.6% |
| | 100.0% | 100.0% | 100.0% | 100.0% |

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Through our home-based services segment we offer a wide range of services, including skilled nursing, private duty nursing, medically-oriented social services, hospice care and physical, occupational and speech therapy. As of September 30, 2009, the home-based services segment was comprised of the following:

| Type of Service | Locations |
|------------------------|------------------|
| Home Health | 223 |
| Hospice | 21 |
| Diabetes Management | 2 |
| Private Duty | 4 |
| Specialty Services | 3 |
| Management Companies | 4 |
| | 257 |

Of our 257 home-based services locations, 135 are wholly-owned by us, 110 are majority-owned or controlled by us through joint ventures, eight are license lease arrangements and we manage the operations of the remaining four locations. We intend to increase the number of home nursing agencies that we operate through continued acquisitions and development throughout the United States.

We provide facility-based services principally through our LTACHs. As of September 30, 2009 we owned and operated five LTACHS with eight locations, of which all but one are located within host hospitals. We also owned and operated two medical equipment locations, a health club and a pharmacy. Of these 12 facility-based services locations, four are wholly-owned by us and seven are majority-owned through joint ventures. We also manage the operations of one inpatient rehabilitation facility in which we have no ownership interest.

Recent Developments**Home-Based Services**

Home Nursing. The base payment rate for Medicare home nursing in 2009 is \$2,272 per 60-day episode. Since the inception of the prospective payment system in October 2000, the base episode rate payment has varied due to both the impact of annual market basket based increases and Medicare-related legislation. Home health payment rates are updated annually by either the full home health market basket percentage, or by the home health market basket percentage as adjusted by Congress. CMS establishes the home health market basket index, which measures inflation in the prices of an appropriate mix of goods and services included in home health services.

On July 30, 2009, CMS issued the calendar year 2010 proposed rule covering agency payment rates for home health services. The proposed rule provides for the following adjustments to the base rate: a 2.2% market basket increase, a 2.75% case mix creep decrease, and a 2.5% increase resulting from a modification to the current outlier policy. The new outlier policy proposes to cap outlier payments at 10% per agency and targets total aggregate outlier payments at 2.5% of total home health payments. The current aggregate target is 5.0% and there is no per agency limit. CMS also identified 1.81% in additional coding creep, leaving 6.89% in total cuts that could be implemented. The proposal lays out three scenarios for addressing the coding creep: 1) maintain the current 2.75% reduction for fiscal year 2010, 2) re-distribute it over two years (3.5% cut in both fiscal year 2010 and fiscal year 2011), or 3) accelerate the entire 6.89% in fiscal year 2010. Each of these scenarios would be offset by the 2.2% market basket increase and the 2.5% increase in the base rate for the outlier adjustment. This proposal goes into a 60-day comment period, and a final rule is expected out thereafter.

The United States Congress is currently working on legislation as part of the Healthcare Reform that could impact the amounts that we are paid by Medicare for services provided to Medicare eligible patients. As of the date of this filing, the legislation has not been finalized and thus we cannot estimate the impact of such potential changes but continue to monitor these actions closely.

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Hospice. On August 8, 2008, CMS issued the Hospice Wage Index for Fiscal Year 2009 Final Rule. This 2009 final rule provides for a payment increase consisting of a 3.6% market basket increase less a 1.1% decrease in the Budget Neutrality Adjustment Factor (BNAF). The 3.6% increase is applied to the national base rates from CMS Transmittal 1570 dated August 1, 2008, and the 1.1% BNAF reduction is applied to the geographically adjusted wage indices as indicated in the Federal Register dated August 8, 2008.

On August 6, 2009 CMS released its Final Fiscal Year 2010 Medicare hospice wage index rule, which will increase hospice rates by 1.4% in FY 2010. The rate increase reflects a 2.1% increase in the hospital market basket, offset by a 0.7% decrease resulting from the phase out of the hospice wage index budget neutrality adjustment factor (BNAF). CMS is phasing out the BNAF reduction over 7 years, with a 10% BNAF reduction in fiscal year 2010 and successive 15% reductions from fiscal year 2011 through fiscal year 2016. The rule is effective October 1, 2009.

Facility-Based Services

LTACHs. On May 6, 2008, CMS published an interim final rule with comment period, which implements portions of the Medicare, Medicaid and SCHIP Extension Act of 2007 (MMSEA). The interim final rule addresses: (1) the payment adjustment for very short-stay outliers, (2) the standard federal rate for the last three months of rate year 2008, (3) adjustment of the high cost outlier fixed-loss amount for the last three months of rate year 2008, and (4) the basis and scope of the LTACH Prospective Payment System (LTACH-PPS) rules in reference to the MMSEA.

On May 9, 2008, CMS published its annual payment rate update for the 2009 LTACH-PPS rate year (RY) 2009 (affecting discharges and cost reporting periods beginning on or after July 1, 2008). The final rule adopts a 15-month rate update, from July 1, 2008 through September 30, 2009 and moves LTACH-PPS from a July-June update cycle to the same update cycle as the general acute care hospital inpatient rule, currently October – September. For RY 2009, the rule increases the Medicare base rate 2.7%, to \$39,114.34 from \$38,086.04. The rule also increases the fixed-loss amount for high cost outlier cases to \$22,960, which is \$2,222 higher than the 2008 LTACH-PPS rate year. The final rule provides that CMS may make a one-time reduction in the LTACH-PPS rates to reflect a budget neutrality adjustment no earlier than December 29, 2010 and no later than October 1, 2012. CMS estimates this reduction will be approximately 3.75%.

On May 22, 2008, CMS published an interim final rule with comment period, which implements portions of the MMSEA not addressed in the May 6, 2008 interim final rule. Among other things, the second May 22, 2008 interim final rule defines a freestanding LTACH as a hospital that: (1) has a Medicare provider agreement, (2) has an average length of stay of greater than 25 days, (3) does not occupy space in a building used by another hospital, (4) does not occupy space in one or more separate or entire buildings located on the same campus as buildings used by another hospital, and (5) is not part of a hospital that provides inpatient services in a building also used by another hospital.

On August 8, 2008, CMS published the final rule for the inpatient rehabilitation facility prospective payment system (IRF-PPS) for fiscal year 2009. The final rule includes changes to the IRF-PPS regulations designed to implement portions of the SCHIP Extension Act. In particular, the patient classification criteria compliance threshold is established at 60% (with co-morbidities counting toward this threshold). In addition to updating the various values that compose the IRF-PPS, the final rule updates the outlier threshold amount to \$10,250. CMS also updated the CMG relative weights and average length of stay values.

On July 30, 2009, CMS published its Final Rule updating payments to LTACHs for the RY 2010. The Final Rule adopted a 2.5% inflation update which will apply to discharges and cost reporting periods beginning October 1, 2009, ending September 30, 2010.

The standard federal rate was raised from the rate proposed in CMS Proposed Rule (NPRM) published on May 1, 2009. Likewise, the high cost outlier (HCO) threshold was lowered from that published in the

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NPRM. The federal standard rate will be \$39,896.65 per Medicare discharge and the HCO threshold will be lowered from \$22,960.00 to \$18,425.00. Both of these developments will have a small positive impact on reimbursement in RY 2010.

The standard federal rate is increased or decreased based on each Medicare patient's case mix index which measures the severity of the patient's condition. The HCO threshold is the limit that triggers additional high cost outlier payments to an LTACH.

Another change to the LTACH PPS worth noting is the labor related share for rate year 2010 will relate to 75.559% of the standard federal rate compared to 75.662% of the standard federal rate for rate year 2009.

Contrary to an earlier notice published by CMS in its June 3rd Interim Final Rule (IFR), CMS is not making any adjustment to the LTACH rates in RY 2010 to adjust for the effect of changes in documentation and coding that occurred in fiscal year 2008, the first year of MS-LTC-DRGs. CMS is, however, finalizing its earlier proposal to adjust the RY 2010 LTACH rates by -0.5% to account for the effect of documentation and coding changes in fiscal year 2007.

The Final Rule also implements the corrections to CMS fiscal 2009 LTACH payments for patients discharged on or after June 3, 2009, through September 30, 2009, that were initially adopted in the June 3rd IFR.

To recap, the standard federal rate uses a 2.0% update factor based on a market basket update of 2.5% less an adjustment of 0.5% to account for changes in documentation and coding.

Office of Inspector General

The Office of Inspector General (OIG) has a responsibility to report both to the Secretary of the Department of Health and Human Services and to Congress any program and management problems related to programs such as Medicare. The OIG's duties are carried out through a nationwide network of audits, investigations and inspections. Each year, the OIG outlines areas it intends to study relating to a wide range of providers. In its fiscal year 2009 workplans, the OIG indicated its intent to study topics relating to, among others, home health, hospice and long-term care hospitals. No estimate can be made at this time regarding the impact, if any, of the OIG's findings.

Results of Operations**Accounts Receivable and Allowance for Uncollectible Accounts**

At September 30, 2009, the Company's allowance for uncollectible accounts, as a percentage of patient accounts receivable, was approximately 12.7%, or \$10.0 million, compared to 14.0% or \$10.0 million at December 31, 2008.

The following table sets forth as of September 30, 2009, the aging of accounts receivable (based on the billing date) and the total allowance for uncollectible accounts expressed as a percentage of the related aged accounts receivable:

| | 0-90 | 91-180 | 181-365 (in thousands) | Over 365 | Total |
|--|------------------|------------------|---------------------------|-----------------|------------------|
| Payor | | | | | |
| Medicare | \$ 40,823 | \$ 9,581 | \$ 6,373 | \$ 1,381 | \$ 58,158 |
| Medicaid | 2,377 | 601 | 962 | 394 | 4,334 |
| Other | 12,144 | 2,570 | 1,320 | 216 | 16,250 |
| Total | \$ 55,344 | \$ 12,752 | \$ 8,655 | \$ 1,991 | \$ 78,742 |
| Allowance as a percentage of receivables | 5.7% | 14.4% | 38.0% | 84.4% | 12.7% |

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For home-based services, we calculate the allowance for uncollectible accounts as a percentage of total patient receivables. The percentage changes depending on the payor and increases as the patient receivables age. For facility-based services, we calculate the allowance for uncollectible accounts based on a claim by claim review. As a result, the allowance percentages presented in the table above vary between the aging categories because of the mix of claims in each category.

The following table sets forth as of December 31, 2008, the aging of accounts receivable (based on the billing date) and the total allowance for uncollectible accounts expressed as a percentage of the related aged accounts receivable:

| | 0-90 | 91-180 | 181-365 (in thousands) | Over 365 | Total |
|---|------------------|------------------|---------------------------|-----------------|------------------|
| Payor | | | | | |
| Medicare | \$ 41,772 | \$ 6,806 | \$ 2,678 | \$ 1,305 | \$ 52,561 |
| Medicaid | 2,807 | 1,081 | 1,108 | 946 | 5,942 |
| Other | 7,656 | 3,239 | 1,219 | 883 | 12,997 |
| Total | \$ 52,235 | \$ 11,126 | \$ 5,005 | \$ 3,134 | \$ 71,500 |
| Allowance as a percentage of receivables <i>Consolidated Net Service Revenue</i> | 6.9% | 15.8% | 33.0% | 94.3% | 14.0% |

Consolidated net service revenue for the three months ended September 30, 2009 was \$132.5 million, an increase of \$34.5 million, or 35.2%, from \$98.0 million for the three months ended September 30, 2008. Consolidated net service revenue for the nine months ended September 30, 2009 was \$389.3 million, an increase of \$118.1 million, or 43.5%, from \$271.2 million for the nine months ended September 30, 2008.

Home-Based Services. Net service revenue for home-based services for the three months ended September 30, 2009 was \$116.7 million, an increase of \$32.2 million, or 38.1%, from \$84.5 million for the three months ended September 30, 2008. Total admissions increased 52.2% to 21,485 during the current period, versus 14,113 for the same period in 2008. Average home-based patient census for the three months ended September 30, 2009, increased 29.5% to 28,150 patients as compared to 21,733 patients for the three months ended September 30, 2008.

Net service revenue for home-based services for the nine months ended September 30, 2009 was \$343.7 million, an increase of \$114.4 million, or 49.9%, from \$229.3 million for the nine months ended September 30, 2008. Total admissions increased 44.2% to 59,368 during the nine months ended September 30, 2009, versus 41,168 for the same period in 2008. Average home-based patient census for the nine months ended September 30, 2009, increased 39.6% to 28,454 patients as compared with 20,386 patients for the nine months ended September 30, 2008.

As detailed in the table below, the increase in revenue is organic growth and the growth from our acquisitions subsequent to the period ending September 30, 2008.

Organic growth includes growth on same store locations (those owned for greater than 12 months) and growth from de novo locations. The Company calculates organic growth by dividing organic growth generated in a period by total revenue generated in the same period of the prior year. Revenue from acquired agencies contributes to organic growth beginning with the thirteenth month after acquisition.

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The following table details the Company's revenue growth and percentages for organic and total growth:

Three Months Ended September 30, 2009 (in thousands except census and episode data)

| | Same Store(1) | De Novo(2) | Organic(3) | Organic Growth % | Acquired(4) | Total | Total Growth % |
|-------------------------|---------------|------------|------------|------------------|-------------|------------|----------------|
| Revenue | \$ 96,630 | \$ 1,517 | \$ 98,147 | 16.1% | \$ 18,599 | \$ 116,746 | 38.1% |
| Revenue Medicare | \$ 81,085 | \$ 1,239 | \$ 82,324 | 15.6% | \$ 14,981 | \$ 97,305 | 36.6% |
| Average Census | 23,745 | 450 | 24,195 | 11.3% | 3,955 | 28,150 | 29.5% |
| Average Medicare Census | 19,283 | 341 | 19,624 | 10.2% | 2,862 | 22,486 | 26.3% |
| Episodes | 33,230 | 851 | 34,081 | 13.3% | 5,597 | 39,678 | 31.9% |

- (1) Same store – location that has been in service with the Company for greater than 12 months.
(2) De Novo – internally developed location that has been in service with the Company for 12 months or less.
(3) Organic – combination of same store and de novo.
(4) Acquired – purchased location that has been in service with the Company for 12 months or less.

Nine Months Ended September 30, 2009 (in thousands except census and episode data)

| | Same Store(1) | De Novo(2) | Organic(3) | Organic Growth % | Acquired(4) | Total | Total Growth % |
|-------------------------|---------------|------------|------------|------------------|-------------|------------|----------------|
| Revenue | \$ 291,039 | \$ 2,354 | \$ 293,393 | 28.0% | \$ 50,309 | \$ 343,702 | 49.9% |
| Revenue Medicare | \$ 245,202 | \$ 2,024 | \$ 247,226 | 29.1% | \$ 39,682 | \$ 286,908 | 49.9% |
| Average Census | 24,075 | 418 | 24,493 | 20.1% | 3,961 | 28,454 | 39.6% |
| Average Medicare Census | 19,789 | 318 | 20,107 | 22.5% | 2,761 | 22,868 | 39.4% |
| Episodes | 104,846 | 1,102 | 105,948 | 24.4% | 12,100 | 118,048 | 38.6% |

- (1) Same store – location that has been in service with the Company for greater than 12 months.
(2) De Novo – internally developed location that has been in service with the Company for 12 months or less.
(3) Organic – combination of same store and de novo.
(4) Acquired – purchased location that has been in service with the Company for 12 months or less.

Facility-Based Services. Net service revenue for facility-based services for the three months ended September 30, 2009, increased \$2.2 million, or 16.3%, to \$15.7 million compared to \$13.5 million for the three months ended September 30, 2008. Patient days increased to 13,043 in the three months ended September 30, 2009 compared to 10,930 in the three months ended September 30, 2008. Patient acuity also increased during the three months ended September 30, 2009 compared to September 30, 2008.

Net service revenue for facility-based services for the nine months ended September 30, 2009, increased \$3.7 million, or 8.8%, to \$45.6 million compared to \$41.9 million for the nine months ended September 30, 2008. Patient days increased to 37,904 in the nine months ended September 30, 2009 compared to 34,262 in the nine months ended September 30, 2008. Patient acuity also increased during the nine months ended September 30, 2009 compared to September 30, 2008.

Cost of Service Revenue

Cost of service revenue for the three months ended September 30, 2009 was \$69.2 million, an increase of \$22.0 million, or 46.6%, from \$47.2 million for the three months ended September 30, 2008. Cost of service revenue represented approximately 52.3% and 48.2% of our net service revenue for the three months ended September 30, 2009 and 2008, respectively.

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Cost of service revenue for the nine months ended September 30, 2009 was \$197.7 million, an increase of \$64.6 million, or 48.5%, from \$133.1 million for the nine months ended September 30, 2008. Cost of service revenue represented approximately 50.8% and 49.1% of our net service revenue for the three months ended September 30, 2009 and 2008, respectively.

Home-Based Services. Cost of home-based service revenue for the three months ended September 30, 2009 was \$59.6 million, an increase of \$20.2 million, or 51.3%, from \$39.4 million for the three months ended September 30, 2008. Cost of home-based service revenue for the nine months ended September 30, 2009 was \$170.6 million, an increase of \$61.5 million, or 56.3%, from \$109.1 million for the nine months ended September 30, 2008.

The following table summarizes cost of service revenue (amounts in thousands):

| | Three Months Ended September 30, | | | | Nine Months Ended September 30, | | | |
|------------------------------|-------------------------------------|----------|-----------|-------|------------------------------------|----------|------------|-------|
| | 2009 | | 2008 | | 2009 | | 2008 | |
| Salaries, wages and benefits | \$ 51,247 | 43.9%(1) | \$ 33,386 | 39.5% | \$ 146,237 | 42.5%(1) | \$ 93,089 | 40.6% |
| Transportation | 3,908 | 3.3% | 2,961 | 3.5% | 11,395 | 3.3% | 8,033 | 3.5% |
| Supplies and services | 4,466 | 3.8% | 3,038 | 3.6% | 12,951 | 3.8% | 8,023 | 3.5% |
| | \$ 59,621 | 51.0% | \$ 39,385 | 46.6% | \$ 170,583 | 49.6% | \$ 109,145 | 47.6% |

(1) Percentage of home-based net service revenue

The increase in salaries, wages and benefits for the three and nine months ended September 30, 2009 compared to the same periods in 2008 relate to an increase in visits per episodes for both Registered Nurses and Physical Therapists.

Facility-Based Services. Cost of facility-based service revenue for the three months ended September 30, 2009 was \$9.6 million, an increase of \$1.8 million, or 23.0%, from \$7.8 million for the three months ended September 30, 2008. Cost of facility-based service revenue for the nine months ended September 30, 2009 was \$27.1 million, an increase of \$3.1 million, or 12.9%, from \$24.0 million for the nine months ended September 30, 2008.

The following table summarizes cost of service revenue (amounts in thousands):

| | Three Months Ended September 30, | | | | Nine Months Ended September 30, | | | |
|------------------------------|-------------------------------------|----------|----------|-------|------------------------------------|----------|-----------|-------|
| | 2009 | | 2008 | | 2009 | | 2008 | |
| Salaries, wages and benefits | \$ 5,850 | 37.2%(1) | \$ 5,029 | 37.3% | \$ 16,601 | 36.4%(1) | \$ 15,173 | 36.2% |
| Transportation | 35 | 0.2% | 48 | 0.4% | 115 | 0.3% | 221 | 0.5% |
| Supplies and services | 3,736 | 23.7% | 2,745 | 20.4% | 10,424 | 22.9% | 8,564 | 20.4% |
| | \$ 9,621 | 61.1% | \$ 7,822 | 58.1% | \$ 27,140 | 59.6% | \$ 23,958 | 57.1% |

(1) Percentage of facility-based net service revenue

The increase in cost of facility-based service revenue relates to the increase in supplies and services as a percentage of facility-based net service revenue. The increase in supplies and services relates to the increase in patient acuity during the periods ending September 30, 2009 compared to the same periods in 2008.

Provision for Bad Debts

Provision for bad debts for the three months ended September 30, 2009 was \$1.1 million, a decrease of \$2.1 million, from \$3.2 million for the three months ended September 30, 2008. For the three months ended September 30, 2009, the provision for bad debts was approximately 1.0% of net service revenue compared to 3.2% for the same period in 2008.

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Provision for bad debts for the nine months ended September 30, 2009 was \$4.1 million, a decrease of \$6.4 million, from \$10.5 million for the nine months ended September 30, 2008. For the nine months ended September 30, 2009, the provision for bad debts was approximately 1.0% of net service revenue compared to 3.9% for the same period in 2008.

Throughout 2008, the Company increased collection efforts, increased cash collections and reduced overall receivables and days sales outstanding. These changes resulted in lower bad debt expense as a percentage of net service revenue at year end December 31, 2008, which continued throughout the nine months ending September 30, 2009.

General and Administrative Expenses

Our general and administrative expenses consist primarily of the following expenses incurred by our home office and administrative field personnel:

Home office:

salaries and related benefits;

insurance;

costs associated with advertising and other marketing activities; and

rent and utilities;

Supplies and services:

accounting, legal and other professional services; and office supplies;

Depreciation; and

Other:

advertising and marketing expenses;

recruitment;

operating locations rent; and

taxes.

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General and administrative expenses for the three months ended September 30, 2009 were \$43.8 million, an increase of \$12.6 million or 40.4%, compared to \$31.2 million for the three months ended September 30, 2008. General and administrative expenses as a percent of net service revenue was 33.1% and 31.9% for the three months ended September 30, 2009 and 2008.

General and administrative expenses for the nine months ended September 30, 2009 were \$126.0 million, an increase of \$38.1 million or 43.3%, compared to \$87.9 million for the nine months ended September 30, 2008. General and administrative expenses as a percent of net service revenue was 32.5% for the nine months ended September 30, 2009 and 32.4% for the nine months ended September 30, 2008.

Home-Based Services. General and administrative expenses in the home-based services for the three months ended September 30, 2009 were \$39.3 million, an increase of \$11.1 million or 39.4% from \$28.2 million for the three months ended September 30, 2008. General and administrative expenses in the home-based services segment represented approximately 33.6% and 33.5% of net service revenue for the three months ended September 30, 2009 and 2008, respectively.

General and administrative expenses in the home-based services for the nine months ended September 30, 2009 were \$114.1 million, an increase of \$36.6 million or 47.2% from \$77.5 million for the nine months ended

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September 30, 2008. General and administrative expenses in the home-based services segment represented approximately 33.2% and 33.8% of net service revenue for the nine months ended September 30, 2009 and 2008, respectively.

Facility-Based Services. General and administrative expenses in the facility-based services for the three months ended September 30, 2009 were \$4.5 million, an increase of \$1.5 million or 50.0% from \$3.0 million for the three months ended September 30, 2008. General and administrative expenses in the facility-based services segment as a percentage of net service revenue were 28.8% and 22.3% for the three months ended September 30, 2009 and 2008, respectively.

General and administrative expenses in the facility-based services for the nine months ended September 30, 2009 and 2008 were \$11.9 million, an increase of \$1.5 million or 14.4% from \$10.4 million for the nine months ended September 30, 2008. General and administrative expenses in the facility-based services segment as a percentage of net service revenue was 26.1% and 24.8% for the three months ended September 30, 2009 and 2008, respectively.

Income Tax Expense

The effective tax rates for the three months ended September 30, 2009 and 2008 were 36.3% and 39.5% of income from continuing operations attributable to LHC Group, Inc., respectively.

The effective tax rate for the nine months ended September 30, 2009 and 2008 was 37.5% and 38.6% of income from continuing operations attributable to LHC Group, Inc., respectively.

The decrease in the effective tax rate relates to the realization of the tax benefit on the net operating loss, on one of the Company's joint ventures, which was fully reserved throughout 2008.

Net Income Attributable to Noncontrolling Interest

Net income attributable to noncontrolling interest was \$3.0 million for the three months ended September 30, 2009 and 2008. Noncontrolling interest represented 2.2% and 3.1% of net service revenue for the three months ended September 30, 2009 and 2008, respectively.

Net income attributable to noncontrolling interest increased \$3.3 million to \$10.8 million for the nine months ended September 30, 2009 from \$7.5 million for the nine months ended September 30, 2008. Noncontrolling interest represented 2.8% of net service revenue for the nine months ended September 30, 2009 and 2008. The increase in net income attributable to noncontrolling interest relates to an increase in the Company's number of joint ventures throughout 2008 as well as an increase in the income from operations related to the joint ventures.

Discontinued Operations

One of the companies acquired during 2008 included operations which are not core to the operations of the Company. During the first quarter of 2009, the Company began marketing these operations and intends to sell them within the next twelve months. The Company allocated \$450,000 to home-based services goodwill related to the operations. As of September 30, 2009, the Company determined that the plan of sale criteria in SFAS No. 144, *Accounting for the Impairment of Disposal of Long-Lived Assets* (ASC 205), has been met, and accordingly, the Company has classified \$450,000 as assets held for sale on the consolidated balance sheet as of September 30, 2009. The operations for the nine months ended September 30, 2009 are included in discontinued operations.

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In September 2009, the Company sold its outpatient rehabilitation clinic. The sale generated a loss of \$23,000, which was recognized in the third quarter of 2009. The results of operations related to the clinic and the loss are included in discontinued operations in the Company's condensed consolidated statements of income.

Discontinued operations for the three and nine months ending September 30, 2008 include the operations of the Company's critical access hospital, which was sold on July 1, 2007.

The following table provides financial results of discontinued operations for the three months and nine months ended September 30, 2009 and 2008:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|---------|------------------------------------|----------|
| | 2009 | 2008 | 2009 | 2008 |
| Net service revenue | \$ 454 | \$ 176 | \$ 1,507 | \$ 493 |
| Costs of services and G&A expenses | (547) | (224) | (1,842) | (1,181) |
| Loss from discontinued operations before noncontrolling interest and income taxes | (93) | (48) | (335) | (688) |
| Income tax benefit | 36 | 18 | 124 | 175 |
| Loss from discontinued operations net of income tax benefit | (57) | 30 | (211) | (513) |
| Less loss from discontinued operations attributable to noncontrolling interest | 0 | 0 | 0 | (241) |
| Loss from discontinued operations attributable to LHC Group Inc.'s common stockholders | \$ (57) | \$ (30) | \$ (211) | \$ (272) |

Liquidity and Capital Resources

Our principal source of liquidity for operating activities is the collection of our accounts receivable, most of which are collected from governmental and third party commercial payors. Our reported cash flows from operating activities are affected by various external and internal factors, including the following:

Operating Results Our net income has a significant effect on our operating cash flows. Any significant increase or decrease in our net income could have a material effect on our operating cash flows.

Timing of Acquisitions We use our operating cash flows for acquisitions. When the acquisitions occur at or near the end of a period, our cash outflows significantly increase.

Start-Up Costs Following the completion of an acquisition, we suspend billing Medicare and Medicaid claims until we receive the change of ownership and electronic funds transfer approvals. We also generally incur substantial start-up costs in order to implement our business strategy. There is generally a delay between our expenditure of these start-up costs and the increase in net service revenue, and subsequent cash collections, which adversely affects our cash flows from operating activities.

Timing of Payroll Our employees are paid bi-weekly on Fridays; therefore, operating cash flows decline in reporting periods that end on a Friday. Conversely, for those reporting periods ending on a day other than Friday, our cash flows are higher because we have not yet paid our payroll.

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Medical Insurance Plan Funding We are self-funded for medical insurance purposes. Any significant changes in the amount of insurance claims submitted could have a direct effect on our operating cash flows.

Medical Supplies A significant expense associated with our business is the cost of medical supplies. Any increase in the cost of medical supplies, or in the use of medical supplies by our patients, could have a material effect on our operating cash flows.

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The following table summarizes changes in cash (amounts in thousands):

| | Nine Months Ended September 30, | |
|--|------------------------------------|-----------|
| | 2009 | 2008 |
| Cash provided by operating activities | \$ 34,784 | \$ 59,434 |
| Cash used in investing activities | (24,605) | (44,818) |
| Cash used in financing activities | (11,182) | (4,620) |
| Change in cash | (1,003) | 9,996 |
| Cash and cash equivalents at beginning of period | 3,511 | 1,155 |
| Cash and cash equivalents at end of period | \$ 2,508 | \$ 11,151 |

Operating cash flows decreased \$24.7 million during the nine months ended September 30, 2009. At September 30, 2009, the Company had working capital of \$45.6 million compared to \$32.1 million at December 31, 2008, an increase of \$13.5 million, or 42.1%. The change in operating cash flow and working capital primarily related to tax payments. As a result of the Hurricanes Ike and Gustav, estimated federal tax payments as well as those for most states, including Louisiana, were deferred until January 2009. The Company paid \$8.5 million on January 3, 2009 related to these deferred payments which reduced operating cash flows in the nine months ended September 30, 2009.

Investing cash outflows decreased \$20.2 million during the nine months ended September 30, 2009. Cash outflows for the nine months ended September 30, 2009 included \$18.5 million for acquisitions compared to \$40.0 million for the nine months ended September 30, 2008.

Financing cash outflows were increased \$6.6 million during the nine months ended September 30, 2009. The increase relates to a \$4.3 million increase in noncontrolling interest distributions during the nine months ended September 30, 2009.

Days sales outstanding at September 30, 2009, was 48 days compared to 52 days at September 30, 2008.

Indebtedness

Our total long-term indebtedness was \$4.6 million at September 30, 2009 and \$5.1 million at December 31, 2008, including the current portions of \$427,000 and \$583,000, respectively.

The Company's Credit Facility with Capital One, National Association, which was amended on June 19, 2009, provides for a maximum aggregate principal borrowing of \$75.0 million. The Credit Facility, which is scheduled to expire on June 10, 2012, is unsecured and has a letter of credit sublimit of \$2.5 million. In September 2009, the Company issued a \$700,000 letter of credit as collateral on the Company's workers compensation insurance. The annual facility fee is 0.25% of the total availability. The interest rate for borrowings under the Credit Facility is a function of the prime rate (Base Rate) subject to a floor or the Eurodollar rate (Eurodollar) subject to a floor, as elected by the Company, plus the applicable margin set forth below, which is based on the Leverage Ratio as defined in the Credit Facility. Other than the letter of credit, no amounts were outstanding on this facility as of September 30, 2009.

| Leverage Ratio | Eurodollar Margin | Base Rate Margin |
|----------------------|----------------------|---------------------|
| <1.00:1.00 | 2.25% | 0.50% |
| ≥1.00:1.00<1.50:1.00 | 2.50% | 0.75% |
| ≥1.50:1.00<2.00:1.00 | 2.75% | 1.00% |
| ≥2.00:1.00 | 3.00% | 1.25% |

The Company's Credit Facility contains customary affirmative, negative and financial covenants. For example, the Company is restricted in incurring additional debt, disposing of assets, making investments, allowing fundamental changes to the Company's business or organization, and making certain payments in

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respect of stock or other ownership interests, such as dividends and stock repurchases. Under the Credit Facility, the Company is also required to meet certain financial covenants with respect to minimum fixed charge coverage, consolidated net worth, leverage and minimum asset coverage ratios. At September 30, 2009, the Company was in compliance with all covenants.

Our Credit Facility also contains customary events of default. These include bankruptcy and other insolvency events, cross-defaults to other debt agreements, a change in control involving us or any subsidiary guarantor, and the failure to comply with certain covenants.

In February 2008, the Company entered into a loan agreement with Capital One, National Association (Capital One) for a term note in the amount of \$5.1 million for the purchase of a 1999 Cessna 560 aircraft. The aircraft is collateral for the term note, which is payable in 83 monthly installments of principal (\$28,056) plus interest commencing on March 6, 2008 followed by one balloon installment on February 6, 2015 of \$2.7 million. The term note bears interest at the LIBOR Rate (adjusted monthly) plus the Applicable Margin of 1.9 percent (2.2% at September 30, 2009).

Contingencies

For a discussion of contingencies, see Item 1, Notes to Consolidated Financial Statements Note 7 Commitments and Contingencies of this Form 10-Q.

Off-Balance Sheet Arrangements

We do not currently have any off-balance sheet arrangements with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. In addition, we do not engage in trading activities involving non-exchange traded contracts. As such, we are not materially exposed to any financing, liquidity, market or credit risk that could arise if we had engaged in these relationships.

Critical Accounting Policies

For a discussion of critical accounting policies, see Item 1, Notes to Consolidated Financial Statements Note 2 Significant Accounting Policies of this Form 10-Q.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As of September 30, 2009, we had cash of \$2.5 million. Cash in excess of requirements remains in the Company's non-interest bearing checking account. As provided by the Stimulus Package all cash limits associated with non-interest bearing checking accounts are fully insured by the Federal Insurance Deposit Corporation through December 31, 2009.

Our exposure to market risk relates to changes in interest rates for borrowings under the Company's Credit Facility. The Credit Facility is a revolving credit facility and, as such, the Company borrows, repays and re-borrows amounts as needed, changing the average daily balance outstanding under the facility. A hypothetical 100 basis point increase in interest rates on the average daily amounts outstanding under the Credit Facility would have increased interest expense \$2,000 for the nine months ended September 30, 2009.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) promulgated under the Exchange Act) that are designed to provide reasonable assurance that information

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required to be disclosed in the Company's reports filed under the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Such information is also accumulated and communicated to management, including the Company's Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. Management of the Company, under the supervision and with the participation of the Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures as of the end of the period covered by this report.

The Company's Chief Executive Officer and Chief Financial Officer concluded that the Company maintained effective disclosure controls and procedures at the reasonable assurance level as of September 30, 2009.

Changes in Internal Controls Over Financial Reporting

There have not been any changes in the Company's internal control over financial reporting, as such term is defined in Rule 13a-15(f) under the Exchange Act, during the period ending September 30, 2009 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

On July 13, 2009, the Company filed a Current Report on Form 8-K regarding an administrative subpoena from the Inspector General of the Office of Personnel Management (OPM). OPM is an administrative agency responsible for overseeing the Federal Employees Health Benefit Program (FEHBP). Although the subpoena was issued by OPM and the Company understood the subpoena and the OPM's review to be limited to the FEHBP, the Company learned on July 9, 2009, that the scope of the review is not limited to the FEHBP, but also extends to service provided to Medicare beneficiaries. At this time there is no clear indication from OPM as to the scope or purpose of the review other than a focus on third-party quality improvement audits performed on the Company's behalf from 2005 to present. The Company will continue to cooperate and provide responsive information for the OPM review.

On April 14, 2009, the Company filed a Current Report on Form 8-K regarding a qui tam lawsuit filed in Tennessee entitled United States of America ex rel Sally Christine Summers v. LHC Group, Inc. claiming a violation of the False Claims Act at a single agency. On June 11, 2009, the Company filed a Current Report on Form 8-K, reporting the district court's order dismissing the case. Summers' counsel is now appealing the court's dismissal, and the Company continues to respond as necessary and appropriate.

ITEM 1A. RISK FACTORS.

The information set forth in this Form 10-Q, should be read in conjunction with the risk factors discussed in Part I, Item 1A. Risk Factors in the Company's 2008 Form 10-K, which could materially affect our business, financial condition or future results. The risks described in the 2008 Form 10-K are not the only risks of the Company. Additional risks and uncertainties not currently known by the Company or that we currently deemed immaterial, also may materially adversely affect the Company.

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ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.

None

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

None

ITEM 5. OTHER INFORMATION.

None

ITEM 6. EXHIBITS.

- 3.1 Certificate of Incorporation of LHC Group, Inc. (previously filed as an exhibit to the Form S-1/A (File No. 333-120792) on February 14, 2005).
- 3.2 Bylaws of LHC Group, Inc. as amended on December 31, 2007 (previously filed as Exhibit 3.1 to the Form 8-K on January 4, 2008).
- 4.1 Specimen Stock Certificate of LHC's Common Stock, par value \$0.01 per share (previously filed as an exhibit to the Form S-1/A (File No. 333-120792) on February 14, 2005).
- 4.2 Reference is made to Exhibits 3.1 and 3.2 (previously filed as an exhibit to the Form S-1/A (File No. 333-120792) on February 14, 2005 and May 9, 2005 and to the form 8-K on January 4, 2008, respectively).
- 4.3 Form of Stockholder Protection Rights Agreement, between LHC Group, Inc. and Computershare Trust Company, N.A., as Rights Agent (previously filed as Exhibit 4.1 to the Form 8-K on March 11, 2008).
- 10.1 Employment Agreement by and between LHC Group, Inc. and John L. Indest dated September 14, 2009.
- 31.1 Certification of Keith G. Myers, Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Peter J. Roman, Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1* Certification of Chief Executive Officer and Chief Financial Officer of LHC Group, Inc. pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

* This exhibit is furnished to the SEC as an accompanying document and is not deemed to be filed for purposes of Section 18 of the Securities Exchange Act of 1934 or otherwise subject to the liabilities of that Section, and the document will not be deemed incorporated by reference into any filing under the Securities Act of 1933.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

LHC GROUP, INC.

Date November 4, 2009

/s/ Peter J. Roman
Peter J. Roman
Executive Vice President and Chief Financial Officer